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FM AMEMBASSY HARARE
TO RUEHC/SECSTATE WASHDC PRIORITY 3988
INFO RUCNSAD/SOUTHERN AF DEVELOPMENT COMMUNITY COLLECTIVE
RUEHUJA/AMEMBASSY ABUJA 2184
RUEHAR/AMEMBASSY ACCRA 2596
RUEHDS/AMEMBASSY ADDIS ABABA 2718
RUEHBY/AMEMBASSY CANBERRA 1987
RUEHDK/AMEMBASSY DAKAR 2342
RUEHKM/AMEMBASSY KAMPALA 2767
RUEHNR/AMEMBASSY NAIROBI 5195
RUEAIIA/CIA WASHDC
RUEHGV/USMISSION GENEVA 1885
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC
RUZEJAA/JAC MOLESWORTH RAF MOLESWORTH UK
RUZEHAA/CDR USEUCOM INTEL VAIHINGEN GE

UNCLAS SECTION 01 OF 03 HARARE 000077

SENSITIVE
SIPDIS

AF/S FOR B. WALCH
AF/EPS FOR ANN BREITER
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR L.DOBBINS AND E.LOKEN
TREASURY FOR D. PETERS
COMMERCE FOR ROBERT TELCHIN
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: N/A
TAGS: EFIN ECON PGOV EMIN EAGR ETRD ZI
SUBJECT: ZIMBABWE BUDGET PROPOSAL LIBERALIZES FOREX
MARKET/PRICES

REF: HARARE 061

SUMMARY

¶1. (SBU) On January 29, Acting Minister of Finance Patrick Chinamasa unveiled a National Budget that, against the backdrop of a sharply contracting and informally dollarized economy, proposes introduction of reforms including liberalization of the foreign currency market and prices. The budget targets 2 percent growth, double-digit inflation, and a GDP of US$5.5 billion in 2009. It commits to ending off-budget expenditures financed by money printing. Casting a chill on the mining industry - the economy's main foreign exchange generator - Chinamasa announced that the Reserve Bank of Zimbabwe (RBZ) will henceforth manage Zimbabwe's diamond and platinum reserves in addition to its gold reserves. The reforms, with the exception of mines and minerals policy, broadly move in the right direction. But the budget grossly underestimates the transacting public's loss of confidence in the local currency and the dearth of foreign currency to finance expenditures or to recapitalize industry. It overestimates the size of GDP, the pace of economic recovery, and the tax collection potential of the moribund private sector. The budget does, however, allow the ruling party to cloak itself in the mantle of reform as it ventures into a government of national unity. END SUMMARY.

Overview of State of the Economy in 2008

¶2. (U) In introducing the 2009 national budget, Chinamasa outlined the extent of the contraction of the pillars of Zimbabwe's economy in 2008. He blamed last year's heavy early rains for the decline in output across all agricultural commodities; output of tobacco, the sector's number one foreign exchange generator, fell, for example, to 45 million kg -- the country's smallest production since the peak of 237 million kg in 2000. He also said the sector had suffered from the shift by growers out of price-controlled maize and wheat into cash crops like soya beans. On mining, Chinamasa stated that most major mines had ceased production due to unfavorable pricing, power outages, foreign exchange scarcity, and skills flight. The manufacturing sector faced an even more difficult situation than agriculture or mining. In regard to tourism, Chinamasa said average hotel room occupancy in 2008 was 39 percent and consisted 91 percent of Zimbabwean nationals.

¶3. (U) On the positive side, Chinamasa said power generation by the Zimbabwe Electricity Supply Authority (ZESA) improved to 922 MW from 569 MW in 2008; domestic potential is 1670 MW while demand is 2279 MW. He blamed sub-economic tariffs, aggravated by vandalism, for the power shortfall. He also Qaggravated by vandalism, for the power shortfall. He also blamed low tariffs for the service delivery failures of the Zimbabwe National Water Authority (ZINWA).

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Growing Balance of Payment Deficit, Weak Trade
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¶4. (U) Reporting on the state of the external sector, Chinamasa said Zimbabwe's balance of payment deficit grew from US$33 million in 2007 to US$410 million last year. Over the same period, exports, consisting 51 percent of minerals, declined 14.32 percent from US$1.606 billion to US$1.376 billion. (NOTE: The U.S. market apparently absorbed about 10 percent of Zimbabwe's exports in 2008; imports by the U.S. amounted to US$107.6 million in the first three quarters of 2008, and consisted mainly of nickel, iron and steel. END NOTE.) Tobacco's contribution to exports fell 24 percent in 2008, agriculture's contribution fell 4.5 percent, that of manufacturing 12 percent, and of tourism 55 percent. Increased food shipments to Zimbabwe drove a 7.6 percent overall increase in imports. Zimbabwe's capital account had a net inflow of US$98.5 million, arising from humanitarian assistance, for which Chinamasa thanked specific donors, including the United States.

Dollarization, Expenditures and Revenue

¶5. (U) Chinamasa announced that all transactions could now be undertaken legally in either local or foreign currency. (NOTE: His budget estimates are in U.S. Dollars based on the UN exchange rate, which is Z$150 quadrillion:US$ today. END NOTE.) He premised the 2009 budget on economic growth of about 2 percent, inflation receding to double-digit levels, GDP of US$5.5 billion, and revenue collection amounting to US$1.7 billion. The budget proposes expenditures of US$1.9 billion (76.3 percent recurrent expenditure and 23.7 percent capital expenditure) of which US$200 million is financial support from donors for food security, health, and education. The largest single government expenditure is the wage bill at US$362 million.

¶6. (U) Chinamasa said the government would avoid money printing beyond the economy's production of goods and services, and end off-budget expenditures. He also announced that the RBZ had liquidated the entire Z$1,111 quintillion balance of its off-budget spending. (COMMENT: Undoubtedly thanks to hyperinflation. END COMMENT.) He promised civil servants periodic review of their local-currency denominated salaries, and, beginning in February 2009, a monthly foreign currency allowance payable through a voucher system. The modalities of the voucher system were being worked out, he said. The projected US$1.7 billion in revenue will come from

corporate taxes, VAT, customs duty, income tax, and other taxes. To increase tax revenue, he announced measures such as an increase in the presumptive tax on informal sector businesses (unregistered hair salons, for example, will pay
Qbusinesses (unregistered hair salons, for example, will pay
US$1,500 in taxes), and a shortened period for remitting taxes.

¶7. (U) The budget proposal allows all schools except primary schools in rural and high-density suburbs to collect tuition and exam fees in local and foreign currencies. ZESA, ZINWA and the National Oil Company of Zimbabwe (NOCZIM), among other parastatals, may now charge in both local and foreign currencies. Electricity tariffs will increase by 47 percent to US$0.098/kWh, payable in both local and foreign currency. Revenue from some consumer categories will cross-subsidize lower tariffs for low-income households. The electric power subsidy to farmers will fall from 55 percent to 20 percent with effect from February 1, 2009. Regarding the disastrous state of water management by ZINWA, Chinamasa said the GOZ would immediately hand back that responsibility to local authorities.

¶8. (U) The Grain Marketing Board will announce import-parity related floor prices for maize and wheat, and take on the diminished role of buyer of last resort. Similarly, the focus of the National Incomes and Pricing Commission (NIPC) will be restricted to monitoring regional prices in order to advise on import-parity pricing.

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Government Tightens Grip on Lucrative Mining Sector
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¶9. (U) Chinamasa announced the reclassification of diamonds, emeralds, and platinum as "reserve assets," on a par with gold, and said that the RBZ would manage development of those three minerals. (COMMENT: Gold production collapsed under RBZ control; platinum production has held its own in a harsh operating environment thanks to contract provisions that allow the offshore retention of earnings. END COMMENT.) He also announced the immediate suspension of unprocessed mineral deposits, including chrome ore and scrap metal.

Monetary Policy

¶10. (U) On February 2, RBZ Governor Gono issued a Monetary Policy Statement that in general supports the thrust of fiscal policy. We will report septel on the Statement and on the reaction of private sector and civil service to the new policies.

COMMENT

¶11. (SBU) The announced reforms, with the exception of all-important mines and minerals policy, broadly move in the right direction. But the budget proposal grossly underestimates the transacting public's loss of confidence in the local currency and the dearth of foreign currency to back a hard currency voucher system for civil servants or to recapitalize industry. It overestimates the size of GDP, the pace of economic recovery, and the tax-generating potential of moribund industry (reftel). The budget makes no mention of allocations to the Defense Ministry or to the President's Office, which traditionally consume a large portion of the budget, and it fails to outline a path for re-engagement with the international financial institutions (IFIs). In particular, it does not indicate how government will begin to clear the arrears with the IFIs that led to the suspension of balance of payments support in the first place. The budget does, however, allow the ruling party and RBZ Governor Gono in particular to cloak themselves in the mantle of reform as ZANU-PF ventures into a government of national unity. END
QZANU-PF ventures into a government of national unity. END

COMMENT.

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